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CREDIT--AN IMPORTANT FARM TOOL IN TODAY'S AGRICULTURE

by
John E. Moore
Extension Economist, Farm Management
Ohio State University

The decision to borrow money and deciding where the capital has the highest opportunity return in the farm business is one of the most important farm management decisions today.

The average value of all farm assets per farm in the U.S. increased from $6,158 per farm in 1940 to $59,519 in 1965. This average is influenced by the large number of small and marginal farms. The investment on the typical commercial farm today would be well above the $100,000 mark and in many cases the total investment would be above $200,000 per farm.

The increasing use of farm credit has increased very rapidly through the years. Today over 75 per cent of the farm transfers are credit financed. A very high percentage of the working or operating capital is credit oriented on many farms.

Many farmers today could increase profits by greater use of credit. Credit helps farmers utilize all their available resources more nearly to capacity. The caution that must be remembered is that the only justification for the use of credit is that the expected returns must exceed the cost of obtaining credit. The first question to answer before considering the use of credit on a farm is: Is there adequate basic farm resources available when combined with credit to make the income that is desired? At this point some of an individual's alternatives might be (a) renting an additional farm; (b) farm a different farm or (c) part or full-time non-farm employment.

Some of the most important factors to consider in making the decision to borrow money are: (a) Purpose of the loan, (b) How much to borrow, (c) When to borrow, and (d) From whom to borrow.

GUIDELINES TO SOUND BORROWING

1. Operating capital generally has higher returns than money invested in land. Loans should be used for production purposes when capital is limited. Fertilizer, seed, productive livestock are examples of investments that may increase net farm income directly.

Loans for family living, repairs, and maintenance that have to be repaid out of farm income are the most damaging to net farm profit.

Select the most profitable investment to use borrowed funds. Use the partial budgeting procedure to help determine where your limited capital has the highest return opportunity on your farm. Compare the profitability of different types of farm enterprises.

2. Be businesslike in your credit operations. Study your farm records and estimate your probable income and expenses to determine the amount of the return available for family living, interest, and principal payment. Keep a farm record book that lends itself to a cash flow budget and a determination of a net worth statement so both can be available for your loan agency to analyze.

   What is the cost of the money? Check the total cost on borrowed money consistent with the service received. Shop for money as you would for any other item of farm production.

   Be fair and frank with your lender. Meet your loan payments promptly. If circumstances prevent you from doing so, notify your lender as far in advance as possible in order that the most satisfactory solution may be worked out.

3. Be sure your repayment plan fits the type of loan you make. Securing a short-term loan for intermediate or long-term obligations puts the borrower in a losing position at the start. Decide what loan period and repayment plan is best. Do you need a one-year, five-year, or twenty-year loan? Usually long-term credit is credit secured for land; intermediate loans for livestock, machinery and buildings; and short-term credit for feed, fuel and fertilizer.

   Agreeing to repay too much of the principal over too short a period will increase the risk of default. Determine the length of credit needed and then shop for credit among lenders who can fill your needs.

4. Borrow the proper amount. Borrowing too much increases the danger of loss. So does borrowing too little. It is important to have sufficient land, livestock and equipment so your labor is productively employed. Generally a farmer with limited capital should give priority for use of his credit to operating loans (livestock and machinery) before he ties up his credit in real estate investments.

A farm unit must be large enough to pay operating and family living expenses as well as interest and principal payments. It is a serious mistake to borrow so little that an inefficient operation results, or so little that the job cannot be completed. On the other hand, your liabilities should not be extended to the point where adverse weather or price will bankrupt you in one or two years time.

The limit to borrowing has to be determined on an individual basis, as a number of factors should be considered. The most important are: One's net worth (assets minus liabilities); earnings over and above operation and living expenses; and management ability. Another factor to consider is this: The greater your equity, the less your chances are of going bankrupt.

5. Protect your loan with insurance. Property insurance to cover the loan could mean the difference between survival and bankruptcy.

   Life insurance without savings features offers the cheapest kind of protection for the farm family with a substantial debt. Term insurance is frequently used for this purpose.

   Direct loan insurance is available from some lenders. Usually direct loan insurance provides for cancellation of the debt in case the borrower dies prior to loan maturity.

   Consideration should also be given to adequate liability insurance.

6. Know your lender. Normally it is not best to borrow from several agencies at one time. Borrowing from a number of different firms indicates poor planning. Many lenders resent their clients obtaining additional loans from other sources without first being consulted. In addition, scattered debts increase the possibility of having an excess amount of principal and interest payments due in the same period.

   One should determine his credit needs sometime in advance of when he needs the loan. Certainly, one should not wait until his needs are urgent before contacting a lender. Sometimes it is very important to have a lender who understands your business. The risk is less hazardous if the lender has a reputation for understanding the importance of extending notes in case of extreme adverse conditions. Avoid lenders who have a record for quick foreclosures during less prosperous times. Becoming acquainted with representatives of credit agencies is time well spent.

   With both short and long term loans the lender will be concerned with the following: the character of the borrower, his financial position and progress, the purpose of the loan, the repayment capacity of the unit, and the kind of security offered.

7. <u>The lender needs to know you.</u>

   (a) Short-term loans--The lender sometimes uses the following indicators to judge the responsibility of the applicant for short-term loans:

      1. Unpaid bills of long standing. Unusual numbers of small bills and judgements may indicate disregard of financial obligations.

      2. Omissions in the financial statement submitted by the applicant. This may indicate carelessness or lack of knowledge. Misrepresentation in the statement is a danger signal.

      3. False or loose statements regarding past production. These also are danger signals.

      4. Bankruptcy, adjustment of debts or other legal means of escaping payment.

   (b) Long-term loans--Factors considered in determing capacity to repay:

      1. Adequate size of business.

      2. High production per unit in the farm enterprise.

      3. Soil productivity.

CAUTION No. 1: Before signing a note or contract be sure you understand:

--When and how the loan is to be repaid.

--The specific property you have pledged as security.

--The interest rate and how it is computed.

--The charges other than interest.

CAUTION No. 2: <u>When you sign another borrowers note</u>, you are making yourself liable for repayment if the other party defaults. Endorsing a note is never "just a formality."